What Every Business Lawyer Needs to Know about Licensing

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<mark>Original presentation had "60 insights in 60 minutes".
Issues for 1/10/08 Licensing Committee discussion are highlighted.</mark>

Who, what, where, when and why

1. Licensor grants to licensee

2. Permission to undertake specified activities with respect to specified subject matter

3. Specified territory or worldwide

4. Specified duration or potentially infinite; conditions of revocability

5. Licensor retains ownership and is compensated by licensee for grant of rights

What can be licensed

6. All or a subset of the licensor's rights, short of transferring ownership

   Difference between a broad exclusive license and assignment: Whereas a licensee may always be concerned about termination of the license, an assignee need not have the same concern.

7. Copyright

   Right to reproduce, prepare derivative works, prepare copies, perform publicly or display publicly – 17 U.S.C. § 106

8. Patent

   Right to exclude others from making, using, selling, offering for sale or importing the claimed invention – 35 U.S.C. § 271

9. Trademark

   Right to prevent others from using a confusingly similar mark – 15 U.S.C. § 1114

10. Trade secret

    Right to use information that derives value from not being generally known and is subject to reasonable efforts to maintain secrecy – Cal. Civ. Code § 3426.1(d)

11. May be expressed in terms of product rather than intellectual property (IP)

    Example: "Adobe grants to you a non-exclusive license to Use the Software for the purposes described in the Documentation as follows."

Why licenses are granted (examples of business reasons)

12. Licensee can exploit but licensor controls (e.g., franchises)

    Example: "[Cendant Corporation], for itself and its subsidiaries, hereby grants to the Licensee and its subsidiaries the exclusive right and license to use the Marks [pertaining to real estate brokerages] in the conduct of the Business…. In conjunction with the use of the Marks, the Licensee shall take all necessary measures to ensure that the services provided by Licensee and its subsidiaries continue to conform to quality standards."

13. IP owner not in a position to manufacture product

    Example: "Research In Motion Limited (RIM) … and NTP, Inc. (NTP) today announced that they have signed a definitive licensing and settlement agreement…. RIM has paid NTP $612.5 million in full and final settlement of all claims against RIM, as well as for a perpetual, fully-paid up license going forward…. The licensing and settlement agreement relates to all patents owned and controlled by NTP and covers all of RIM's products, services and technologies…, including its BlackBerry® related business."

14. IP enhances existing products

    Example: "Bacterin International designs, tests and licenses bioactive coatings [to] medical device manufacturers…."

15. Multiple players can penetrate market(s) more quickly

    Example: Microsoft licensing of DOS and Windows to PC manufacturers vs. Apple's restriction of its operating systems to Macintosh computers.

Most-important / most-negotiated provisions

16. Scope of license – permitted activities

    See, e.g., Sections 7 through 10 of this document.

17. Scope of license – licensee's contractors / sub-licensees

    Example: "Licensee will have, and Licensor hereby grants to Licensee, the right to grant sublicenses to third parties under the License so long as Licensee pays, with respect to such sublicenses, all applicable Royalties."

    Example: "Attached hereto as Exhibit G is Licensor's Supplier Code of Conduct (the "Code") which applies to any entity manufacturing merchandise under the Tommy Hilfiger® label (including the components thereof). Licensee shall ensure that Licensee, and all Sublicensees, Third Party Manufacturers, subcontractors and suppliers comply with the terms of the Code…."

18. Scope of license – quantity / geographic / technical / industry limitations

Example: "Customer may (1) use the Software for production purposes in more than one IBM Customer Information Control System (CICS) or equivalent address space on each Designated Mainframe only if each is running under one copy of IBM Multiple Virtual Storage (MVS) or LPAR or equivalent and the multiple CICS address spaces are communicating with each other using IBM Multi-Region Option (MRO) or equivalent; (2) use the Software, for test and development purposes only, in one additional CICS address space of a licensed CPU/LPAR/MVS on the Designated Mainframe; and (3) use the Software on the Designated PCs or Servers; for the stated Applications; and within the stated Usage Limits."

19. Price – up-front payment

Example: "As non-refundable consideration for grant of the License, Licensee will pay Licensor the sum of $100,000.00 (one hundred thousand dollars) by wire transfer of immediately available funds promptly upon execution of this Agreement."

20. Price – recurring payments / license fees / advances against royalties

Example: "For the first four (4) Agreement Years, Licensee will pay to Licensor the minimum amounts set forth in the following schedule (the "Minimum Annual Royalty"). Each of these four (4) payments shall be due and payable on the anniversary of the Effective Date of this Agreement."

21. Price – royalties

Example: "As additional consideration for grant of the License, Licensee shall pay to Licensor 'Licensed Product Royalties' in the amount of 4% (four percent) of the Net Selling Price for Licensed Products sold."

22. Revenue basis for computing royalties

Example: "'Net Selling Price' means the gross invoice revenue received by Licensee (or Licensee's sublicensee, as applicable) for the sale or other provision of the Licensed Product, less the sum of the following actual and customary deductions, where applicable: (a) discounts and rebates against such revenue; (b) sales, use, withholding, excise and other taxes, tariffs, import/export duties, and transportation charges, to the extent included in such revenue (but excluding taxes on the net income of Licensee and its sublicensees); (c) allowances or credits because of rejections or returns; and (d) loss or damage in transit that is not reimbursed."

23. Audit provisions

Example: "During the term of this Agreement and for two years thereafter, Licensee will keep full, true and accurate records containing information required to confirm all amounts payable to Licensor hereunder. Upon reasonable notice, Licensor or its accountant may inspect and audit said records on an annual basis during normal business hours to verify Licensee's payments hereunder and compliance with this Agreement. Licensor will bear the fees and expenses of such inspection and audit unless same reveals that Licensee has underpaid Licensor by at least 10% (ten percent) during any calendar year, in which case Licensee will promptly reimburse Licensor for such fees and expenses."

24. Associated services

   Example: "Upon Customer's payment of the amounts set forth in the Annual Maintenance column of Attachment 1 and so long as Customer is not in material breach of this Agreement, for one year from the Effective Date Supplier will provide Maintenance and Support for the Products for which such payment was made. 'Maintenance and Support' means the services specified in Attachment 4."

25. Warranties and indemnification

   Example: "THE ENCLOSED SOFTWARE IS PROVIDED 'AS IS', WITHOUT WARRANTY OF ANY KIND, EITHER EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO IMPLIED WARRANTIES OF MERCHANTABILITY AND FITNESS FOR A PARTICULAR PURPOSE, WITH RESPECT TO THE SOFTWARE, AND ANY OTHER ACCOMPANYING MATERIALS."

   Example: "Supplier warrants that (a) except as set forth in applicable Documentation, Software will not contain any disabling code or similar device that prevents Customer from using Software in the intended manner; (b) to the best of Supplier's knowledge, Software does not contain any computer virus or other malicious code that will cause material damage to Customer; and (c) Supplier will provide Services in a professional and workmanlike manner to standards generally accepted in the industry. Customer's exclusive remedy for a material breach of warranty with respect to a Product will be to require Supplier to use commercially reasonable efforts to bring the Product into conformance with the warranty. Customer's exclusive remedy for a material breach of warranty with respect to a Service will be to require Supplier to re-perform the Service in accordance with the warranty. THE FOREGOING WARRANTIES AND REMEDIES CONSTITUTE THE ONLY WARRANTIES WITH RESPECT TO PRODUCTS AND SERVICES, AND CUSTOMER'S EXCLUSIVE REMEDIES FOR BREACH OF THOSE WARRANTIES. THESE EXPRESS WARRANTIES ARE IN LIEU OF ALL OTHER WARRANTIES, WRITTEN OR ORAL, STATUTORY, EXPRESS, OR IMPLIED. SUPPLIER EXPRESSLY DISCLAIMS ANY WARRANTY OF MERCHANTABILITY, AN ANY WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE, AND ANY WARRANTY OF NON-INFRINGEMENT."

   Example: "Supplier will defend, indemnify and hold Customer harmless from all costs, expenses, and damages arising from any third-party claim alleging that any Software or Documentation infringes any U.S. patent, copyright, trade secret, or other intellectual property right (a "Claim"), provided that Customer has given Supplier prompt notice of the Claim, allows Supplier sole control of the defense of the Claim and of all negotiations for its settlement or compromise, and cooperates in all reasonable ways with Supplier's defense or settlement of the Claim. Supplier will have no liability to Customer for any Claim that is based on or arises out of use of Software in any environment other than the Authorized Environment. If a Claim results in an injunction precluding Customer's use of the Software, Supplier will, at its option and expense, either: (a) procure for Customer the right to continue the enjoined use; or (b) replace or modify the Software or Documentation so it is no longer subject to the injunction. If Supplier, after all commercially reasonable efforts, is unable to perform under either option (a) or (b) above, then, upon Customer's return of all Products to Supplier, and Customer's certification to Supplier under oath that it has destroyed all copies of the Software made by it, Supplier will refund to Customer an amount equal to the undepreciated/unamortized balance of the Product Price carried on Customer's books for U. S. federal income tax purposes as of the date that use of the Products was enjoined."

26. Limitations of liability and damages

Example: "NEITHER PARTY WILL BE LIABLE TO THE OTHER FOR ANY INCIDENTAL OR CONSEQUENTIAL DAMAGES OF ANY NATURE OR FOR ANY REASON ARISING OUT OF THIS AGREEMENT, OR FOR ANY CLAIM AGAINST THE OTHER BY ANY THIRD PARTY, EVEN IF ADVISED OF THE POSSIBILITY OF SUCH DAMAGES OR CLAIMS. THE MAXIMUM CUMULATIVE LIABILITY OF SUPPLIER FOR ANY AND ALL DAMAGES ARISING OUT OF THIS AGREEMENT WILL NOT EXCEED THE TOTAL AMOUNT THAT CUSTOMER HAS ACTUALLY PAID TO SUPPLIER HEREUNDER."

27. Confidentiality

Example: "'Confidential Information' means non-public information about a Party that the other Party gains access to in oral, written, electronic or any other form in the course of carrying out this Agreement. Each Party will protect the other Party's Confidential Information by (i) using it only for the purposes of this Agreement, (ii) disclosing it only to the Party's personnel strictly on a need-to-know basis and not to any third party, (iii) taking such measures as it takes to protect its own confidential information of like kind, and in any event a reasonable level of care, and (iv) returning it and all copies thereof to the other Party on demand at any time with reasonable notice. The obligations set forth in the preceding sentence will not apply in the event, and only to the extent, that the Confidential Information is (i) already in the Party's possession without obligation of confidentiality, (ii) obtained from a source other than the other Party without obligation of confidentiality, (iii) independently developed by the Party, (iv) disclosed by the other Party to a third party without obligation of confidentiality, or (v) required to be disclosed by applicable law or governmental order, in which case the Party will, as promptly as possible and before making the disclosure, notify the other Party of its intention to make the disclosure.

28. Third-party infringement

Example: "In the event that at any time hereafter there is not pending a suit by Licensor against an infringer of the Licensed Patent, then, in such case, Licensee will have the right to file suit against such infringer, in the name of Licensor and at Licensee's expense and for Licensee's benefit. Licensor consents to be a party and to cooperate with Licensee in any such suit brought by Licensee pursuant to this paragraph."

29. Invalidation of underlying IP

Example: "Royalties will be paid by Licensee on its products that use any invention covered by any pending claim of the Patent Applications; provided, however, that if letters patent do not issue within three (3) years after the date of this Agreement with a claim or claims covering an invention used in Licensee's products, and none of the Patent Applications (or continuations or divisions of them) pending at the end of the three (3) years contains an allowed claim having such coverage, Licensee may thereafter, at its option, terminate this agreement by giving thirty (30) days' notice to that effect to Licensor."

30. Breach and remedies

Example: "A Party at any time may provide written notice to the other Party of termination of this Agreement for a material breach thereof. Such termination will be effective ninety (90) days after the date of the notice unless before the end of that period the other Party cured the breach

identified in the notice. If the breach is cured in the specified period, the notice of termination will be void and of no effect. The right of either Party to terminate under the provisions of this Article will not be an exclusive remedy, and either Party will be entitled, if the circumstances warrant, alternatively or cumulatively, to damages for breach of this Agreement, to an order requiring performance of obligations of this Agreement, or to any other remedy available at law or equity."

31. Choice of law, jurisdiction and venue

Example: "This Agreement will be governed by and construed in accordance with the laws of the State of California excluding its conflict of laws provisions. The Parties consent to the exclusive jurisdiction of the state and federal courts in the County of Santa Clara, California and expressly waive any objection or defense based on lack of personal jurisdiction or venue in connection with any dispute arising out of or relating to this Agreement or its breach."

32. Attorneys' fees

Concern: Whether an attorneys' fee provision increases the likelihood of litigation.

Cal. Civ. Code § 1717(a): In any action on a contract, where the contract specifically provides that attorney's fees and costs, which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs….

Special considerations

33. Exclusivity

   Exclusive license normally costs more than non-exclusive.

   With respect to patent licenses, an exclusive licensee generally can sue infringers on its own behalf.

34. Assignability

   Assignment by licensee often is prohibited because licensor wants to (a) control who has access to the technology (e.g., keep out of the hands of competitors) or (b) increase revenue.

35. Shrink-wrap

   Opening package or using software constitutes acceptance of license terms. Limited case authority is that shrink-wrap licenses are enforceable (which is appropriate if for no reason other than economic practicality).

36. Click-through

   User must click on "I agree" (or something similar) before using software. As with shrink-wrap there is limited authority, but the argument for enforceability is at least as strong because the user takes affirmative action acknowledging acceptance of terms.

37. Open source / free software

Users' freedom to run, copy, distribute, study, change and improve the software.

Example: GNU General Public License, http://www.gnu.org/copyleft/gpl.html

Risk: Incorporation of open source may change product from proprietary to open source.

38. OEM (Original Equipment Manufacturer) / reseller opportunities

Focus on (a) how licensee can modify / incorporate licensed technology and (b) rights licensee can grant to its sublicensee customers.

39. Office lease + rooftop antenna license

Re real estate lease / license / easement, see, e.g., University of California, *When to Use A Lease, License, Easement,* http://www.ucop.edu/facil/resg/leasing/documents/leaselicense.pdf.

40. Music

Public performance licenses – ASCAP, http://www.ascap.com; BMI, http://www.bmi.com; SESAC, http://www.sesac.com

"Mechanical" (recording) licenses – Harry Fox Agency, http://www.harryfox.com

41. Not-for-profit organizations

Licensors may provide more-favorable terms than normal.

42. Sales tax

There is no sales tax on prewritten software for California purchasers if it is downloaded electronically or installed by the supplier ("load and leave") and the customer does not receive any tangible personal property. Cal. Bd. of Equalization Sales and Use Tax Reg. 1502(f)(1)(D), http://www.boe.ca.gov/pdf/reg1502.pdf

43. U.S. government funding

Some government contracts restrict which costs can be reimbursed. May lead to contractor's request that licensor agree to characterize as royalties certain payments that normally could be characterized otherwise.

44. U.S. government appropriation – eminent domain

The U.S. government does not license rights under patents or copyrights – it acquires rights under its eminent domain powers and pays reasonable compensation.

➔ Ask Dana for a copy of his article, *Patents, Copyrights, Government*, California Bar Journal (April 2005).

45. International licenses

Tends to make choice-of-law negotiations (see Section 31) more significant and more contentious.

Parties typically exclude application of the United Nations Convention on Contracts for the International Sale of Goods. (Article 6: "The parties may exclude the application of this Convention….")

46. Moral rights

In many other countries: The right of an author to control the fate of his work to protect the personal and reputational value of the work. May include the right to receive or decline credit, prevent alteration, control ownership, or dictate whether or how displayed.

In the U.S.: Primarily applies to visual art under the Visual Artists Rights Act of 1990 (17 U.S.C. § 106A).

Moral rights cannot be assigned but can be waived. Particularly important issue for companies having work done by contractors as well as employees (see next Section).

47. Startups and ownership of IP

You can't license to customers a product that you don't own!

➔ Ask Dana for a copy of his article, *The Top Ten Intellectual Property Mistakes of Start-up Entrepreneurs*.

48. Cross-licensing / more than two parties

Often used to resolve or avoid litigation between companies with large patent portfolios.

49. Non-compete provisions – scope and enforceability

Cal. Bus. & Prof. Code § 16600. Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.

Exceptions: § 16601 – sale of goodwill of business; § 16602 – dissolution of or disassociation from partnership; § 16602.5 – dissolution of LLC.

50. Perfection of license rights to establish priority

Copyright – no online recordation; information at http://www.copyright.gov/document.html
Electronic Patent Assignment System (EPAS), http://epas.uspto.gov/
Electronic Trademark Assignment System (ETAS), http://etas.uspto.gov/

Cal. Comm. Code § 9505 allows the filing of a financing statement using the terms "licensor" and "licensee" rather than "secured party" and debtor".

51. <mark>Bankruptcy and escrows (protecting against the licensor going out of business)</mark>

If the debtor/licensor rejects an executory license, Bankruptcy Code § 365(n) allows the licensee to (a) treat the license as terminated and assert damages for breach or (b) retain its rights under the license (does not apply to trademarks or service marks).

Technology escrows – Iron Mountain, http://www.ironmountain.com/ipm/escrow/

Negotiation process

52. Business and legal interplay

Observation: A client's interest in a legal issue is directly related to the issue's potential impact on the client's business.

53. <mark>Risk vs. reward</mark>

Observation: The more conservative the company, the more it focuses on risk mitigation and the less it focuses on reward enhancement.

54. <mark>Industry and players</mark>

Observation: Ownership of a patent does not guarantee that it can be licensed successfully. There is no substitute for knowing key companies in the industry and where they are going.

55. Business and profitability models

Observation: The more the parties know about one another's business and profitability models, the more quickly and more easily they can negotiate appropriate license fees.

➔ Ask Dana for a copy of his article, *Recognizing the Right Royalty Rate*.

56. Common industry practices

Observation: A party's perception of what is "standard" in the industry may reflect the party's history rather than the industry as a whole.

Resolving disputes

57. Escalation

Example: If any dispute arises, the parties' project managers will try to resolve it within five business days (or such other time period as the project managers may agree on). Failing such resolution, the project managers will refer the dispute to their respective Vice Presidents for resolution. If those personnel cannot resolve the dispute, the parties may pursue legal and equitable remedies as set forth below.

58. Mediation and arbitration

   Example: The parties agree to mediate any dispute or claim arising between them out of this agreement before resorting to arbitration or court action. Mediation fees, if any, shall be divided equally between the parties. If, for any dispute or claim to which this paragraph applies, any party commences and action without first attempting to resolve the matter through mediation or refuses to mediate after a request has been made, then that party shall not be entitled to recover attorneys' fees, even if they would otherwise be available to that party in any such action.

   Example: Any controversy or claim arising out of or relating to this contract, or the breach thereof, shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

   Typically carved out (may seek equitable relief in court without requirement to post a bond): Breach of license restrictions or confidentiality.

59. High cost of litigation

   Intellectual property litigation is particularly expensive.

60. Courts' (limited) expertise and (lack of) speed

   In the Bay Area, federal and state courts in Santa Clara County (the heart of Silicon Valley) generally are recognized as having superior knowledge of technology and the ability to move cases relatively quickly.

This document is not intended as, and should not be considered, legal advice. Examples are illustrative and do not necessarily represent best practices or legally sufficient provisions. If you need legal advice, please utilize the services of a qualified attorney.

Dana H. Shultz is a business-savvy licensing, intellectual property and technology transactions attorney with an office in Piedmont. Before starting his own law practice (www.danashultz.com), he had more than a decade of in-house experience at companies ranging in size from pre-IPO to multinational. Dana's positions included Vice President and Legal Counsel at Visa International, General Counsel at Baron Data Systems, and Senior Staff Attorney at Lexis-Nexis. His work experience also includes management consulting in information technology; litigation support marketing and sales; and software development, all of which combine to give him an in-depth understanding of business operations that adds value to his legal skills and services.

Dana is a founding member of the Bay Area Business Attorneys Network, a member of the International Technology Law Association and the Licensing Executives Society, and a contributor to the California Bar Journal. He received an undergraduate degree in Communication Science from the University of Michigan and a J.D. from the University of California at Berkeley, Boalt Hall School of Law.